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SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-68879; File No. SR-CBOE-2012-124)

February 8, 2013

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Approving a Proposed Rule Change to Amend Various CBOE Rules Governing Letters of Guarantee and Authorization

On December 14, 2012, the Chicago Board Options Exchange, Incorporated (“Exchange” or “CBOE”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend various CBOE Rules governing letters of guarantee and authorization. The proposed rule change was published for comment in the Federal Register on December 27, 2012.<sup>3</sup> The Commission did not receive any comment letters on the proposal. This order approves the proposed rule change.

I. Description of the Proposal

As further described below, each Trading Permit Holder (“TPH”) that has trading functions on CBOE currently is required to submit to CBOE a letter of guarantee or authorization for its trading activities on CBOE from a Clearing Trading Permit Holder (“Clearing TPH”). Typically, by a letter of guarantee, the Clearing TPH guarantees any trades made its TPH customer and, by a letter of authorization, a Clearing TPH accepts financial responsibility for all transactions on CBOE made by a guaranteed Floor Broker.

The purpose of the proposal is to amend various CBOE rules governing letters of

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Securities Exchange Act Release No. 68487 (December 20, 2012), 77 FR 76320 (“Notice”).

guarantee and authorization to:

- give CBOE the ability to prevent access to its marketplace if a TPH does not have an effective letter of guarantee or authorization on file with the Exchange;
- provide that any written revocation of a letter of guarantee or authorization will be given effect as quickly as CBOE can process it;
- give CBOE the ability to take any action necessary to give effect to actions by the Clearing Corporation<sup>4</sup>, such as restricting the activities of a Clearing TPH or suspending a Clearing TPH;
- automatically terminate the trading permit(s) and TPH status of a TPH if the TPH does not have a required letter of guarantee or authorization in place for ninety consecutive days;
- delete obsolete and outdated rule text; and
- make technical, non-substantive rule text changes.

Generally, these substantive changes are designed to ensure that TPHs who engage in trading activities always have a valid letter of guarantee or authorization from a Clearing TPH.

Changes to Rule 3.28 (Letters of Guarantee). The Exchange proposes to amend CBOE Rule 3.28 so that it will govern both letters of guarantee and authorization.<sup>5</sup> The Exchange proposes to add new paragraphs (b) through (g) to expressly provide CBOE with remedial powers in the event the OCC restricts or suspends a Clearing TPH. The Exchange also proposes to add new paragraph (h) to Rule 3.28 to govern the termination of TPH status when a TPH is

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<sup>4</sup> Currently, The Options Clearing Corporation (“OCC”) is the only Clearing Corporation of CBOE. See Notice, supra note 3, at 76320, n.5.

<sup>5</sup> Currently, the rule governs only letters of guarantee. Rule 6.72 will continue to govern Letters of Authorization for Floor Brokers and Rule 8.5 will continue to govern Letters of Guarantee for Market-Makers.

without a required letter of guarantee or authorization for a period of ninety consecutive days.

Under new paragraph (b) of the rule, a TPH may not engage in any trading activities on the Exchange if an effective letter of guarantee or authorization required to engage in those activities is not on file with the Exchange. If a Trading Permit Holder does not have an effective letter of guarantee or authorization on file with the Exchange, the Exchange will be permitted to prevent access and connectivity to the Exchange by that Trading Permit Holder. If a TPH has a letter of guarantee or authorization that is revoked or invalidated (as discussed below), that TPH's orders and quotes will be rejected after the revocation or invalidation after the revocation or invalidation becomes effective unless and until the TPH has another effective letter of guarantee or authorization in place and on file with the Exchange. This means that a TPH without an effective letter of guarantee or authorization will not be able to continue to trade on the Exchange.

Under new paragraph (c) of the rule, letters of guarantee and authorization filed with the Exchange will remain in effect until a written notice of revocation has been filed with the TPH Department and the revocation becomes effective or the letter of guarantee or authorization otherwise becomes invalid pursuant to Exchange rules. A written notice of revocation will become effective as soon as the Exchange is able to process the revocation. A revocation will in no way relieve a Clearing TPH of responsibility for transactions guaranteed prior to the effectiveness of the revocation.

Under new paragraph (d) of the rule, if the OCC restricts the activities of a Clearing TPH or suspends a Clearing TPH as a Clearing Member of the OCC, the Exchange will be permitted to give effect to the restriction or suspension. For example, if the OCC restricts transactions cleared by a Clearing TPH to "closing only" transactions, the Exchange similarly will be able to

restrict transactions on the Exchange for clearance by that Clearing TPH as a Clearing Member of the OCC to “closing only” transactions; if the OCC suspends a Clearing TPH, the Exchange similarly will be able to prevent access and connectivity to the Exchange by the suspended Clearing TPH.

Under new paragraph (e) of the rule, if a Clearing TPH’s status as a Clearing Member of the OCC is terminated or if a Clearing TPH’s status as a CBOE TPH is terminated, all letters of guarantee and authorization on file with the Exchange from that Clearing TPH will no longer be valid, effective as of the time the Exchange processes the invalidation of those letters. Similarly, under new paragraph (f) of the rule, if a Clearing TPH has been suspended as a Clearing Member of the OCC or as a CBOE TPH, all existing letters of guarantee and authorization from that Clearing TPH will be invalid during the period of the suspension, effective as soon as the Exchange processes the invalidation of those letters.<sup>6</sup> New paragraph (g) of the rule provides that the invalidation of a letter of guarantee or authorization will in no way relieve the Clearing TPH that issued the letter of guarantee or authorization of responsibility from transactions guaranteed prior to the effectiveness of the invalidation.

Lastly, under the terms of new paragraph (h) of the rule, if a TPH does not have a required letter of guarantee or authorization for period of ninety consecutive days, its trading permit(s) and status as a TPH shall automatically terminate.

Changes to Rule 6.72 (Letters of Authorization). The Exchange proposes to amend CBOE Rule 6.72 to provide that a letter of authorization previously filed with the Exchange will remain effective until a written notice of revocation has been filed with the TPH Department and

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<sup>6</sup> The Exchange states that it will endeavor to process revocations and invalidations under proposed Rules 3.28(c) and 3.28(f) in a timely manner. See Notice, supra note 3, at 76321.

the revocation becomes effective or until such time that the letter of authorization otherwise becomes invalid under CBOE's rules. In the event a written notice of revocation is provided, the Exchange is proposing to provide that the revocation shall become effective as soon as the Exchange is able to process it.<sup>7</sup> The Exchange also proposes to eliminate a provision that allows a Clearing TPH to request that the Exchange post notice of the revocation.

The Exchange also proposes to add an internal cross reference, which provides that letters of authorization issued for Floor Brokers under Rule 6.72 will be subject to Rule 3.28.<sup>8</sup> The effects of this addition would:

- allow CBOE to prevent access to its marketplace if a Floor Broker TPH does not have an effective letter of authorization on file with the Exchange;
- allow CBOE to take action necessary to give effect to actions by the Clearing Corporation, such as restricting the activities of a Clearing TPH or suspending a Clearing TPH;
- allow CBOE to invalidate a Floor Broker's letter of authorization if it was issued by a Clearing TPH whose Clearing TPH status as a Clearing Member of the OCC is terminated or if a Clearing TPH's status as a CBOE TPH is terminated effective as soon as the Exchange is able to process the invalidation of the letter of authorization;
- allow CBOE to invalidate a Floor Broker's letter of authorization, if it was issued by a Clearing TPH who has been suspended as a Clearing Member of the OCC or as a CBOE TPH, during the period of the suspension effective as soon as the Exchange is able to process the invalidation of the letter of authorization;

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<sup>7</sup> Currently, the rule sets forth a specific time period for the effectiveness revocations.

<sup>8</sup> Previously, letters of authorization issued to Floor Brokers were governed only by Rule 6.72.

- provide that the invalidation of a letter of authorization shall in no way relieve the Clearing TPH that issued the letter of authorization of responsibility from transactions guaranteed prior to the effectiveness of the invalidation; and
- automatically terminate the trading permit(s) and TPH status of a Floor Broker if the Floor Broker does not have a required letter of guarantee or authorization in place for ninety consecutive days.

Changes to Rule 8.5 (Letters of Guarantee). The Exchange proposes to amend CBOE Rule 8.5 to provide that a letter of guarantee previously filed with the Exchange will remain effective until a written notice of revocation has been filed with the TPH Department and the revocation becomes effective or until such time that the letter of guarantee otherwise becomes invalid under CBOE's rules. In the event a written notice of revocation is provided, the Exchange is proposing to provide that the revocation shall become effective as soon as the Exchange is able to process it.<sup>9</sup> The Exchange also proposes to eliminate a provision that allows a Clearing TPH to request that the Exchange post notice of the revocation.

Additionally, the Exchange proposes to add an internal cross-reference, which provides that letters of guarantee issued for Market-Makers under Rule 8.5 will be subject to Rule 3.28.<sup>10</sup> The effects of this addition would:

- allow CBOE to prevent access to its marketplace if a Market-Maker TPH does not have an effective letter of guarantee on file with the Exchange;
- allow CBOE to take action necessary to give effect to actions by the Clearing Corporation, such as restricting the activities of a Clearing TPH or suspending a

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<sup>9</sup> Currently, the rule sets forth a specific time period for the effectiveness revocations.

<sup>10</sup> Previously, letters of authorization issued to Market Makers were governed only by Rule 8.5.

Clearing TPH;

- allow CBOE to invalidate a Market-Maker's letter of guarantee if it was issued by a Clearing TPH whose Clearing TPH status as a Clearing Member of the OCC is terminated or if a Clearing TPH's status as a CBOE TPH is terminated effective as soon as the Exchange is able to process the invalidation of the letter of guarantee;
- allow CBOE to invalidate a Market-Maker's letter of guarantee, if it was issued by a Clearing TPH who has been suspended as a Clearing Member of the OCC or as a CBOE TPH, during the period of the suspension effective as soon as the Exchange is able to process the invalidation of the letter of guarantee;
- provide that the invalidation of a letter of guarantee shall in no way relieve the Clearing Trading Holder that issued the letter of guarantee of responsibility from transactions guaranteed prior to the effectiveness of the invalidation; and
- automatically terminate the trading permit(s) and TPH status of a Market-Maker if the Market-Maker does not have a required letter of guarantee or authorization in place for ninety consecutive days.

Further, the Exchange proposes to delete Interpretations and Policies .01, .02 and .04 from Rule 8.5 because it states that they are obsolete.<sup>11</sup>

Changes to Rules 24A.15 and 24B.13 (Letters of Guarantee or Authorization). The Exchange proposes to amend Rules 24A.15 and 24B.13, which relate to FLEX options, by deleting a provision in each rule relating to OCC approval of letters of guarantee that are being amended to include FLEX option transactions. According to the Exchange, that provision is

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<sup>11</sup> The Exchange states that it no longer trades the product referenced in .01, and .02 and .04 are obsolete because the OCC is no longer involved in approving CBOE letters of guarantee. See Notice, supra note 3, at 76322.

obsolete because the OCC is no longer involved in approving CBOE letters of guarantee.<sup>12</sup>

Additionally, the Exchange proposes to add an internal cross-reference, which provides that letters of guarantee or authorization issued for FLEX Market-Makers and Floor Brokers under Rules 24A.15 and 24B.13 will be subject to Rule 3.28.<sup>13</sup> The effects of this addition would:

- allow CBOE to prevent access to its marketplace if a FLEX Market-Maker or Floor Broker TPH does not have an effective letter of guarantee or authorization on file with the Exchange;
- allow CBOE to take action necessary to give effect to actions by the Clearing Corporation, such as restricting the activities of a Clearing TPH or suspending a Clearing TPH;
- allow CBOE to invalidate a FLEX Market-Maker or Floor Broker TPH's letter of guarantee or authorization if it was issued by a Clearing TPH whose Clearing TPH status as a Clearing Member of the OCC is terminated or if a Clearing TPH's status as a CBOE TPH is terminated effective as soon as the Exchange is able to process the invalidation of the letter of guarantee or authorization;
- allow CBOE to invalidate a FLEX Market-Maker or Floor Broker TPH's letter of guarantee or authorization, if it was issued by a Clearing TPH who has been suspended as a Clearing Member of the OCC or as a CBOE TPH, during the period of the suspension effective as soon as the Exchange is able to process the invalidation of the letter of guarantee or authorization;

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<sup>12</sup> See id.

<sup>13</sup> Previously, letters of authorization issued to FLEX Market-Makers or Floor Brokers were only governed by Rules 24A.15 and 24B.15.



- provide that the invalidation of a letter of guarantee or authorization shall in no way relieve the Clearing Trading Holder that issued the letter of guarantee or authorization of responsibility from transactions guaranteed prior to the effectiveness of the invalidation; and
- Automatically terminate the trading permit(s) and TPH status of a FLEX Market-Maker or Floor Broker if the FLEX Market-Maker or Floor Broker does not have a required letter of guarantee or authorization in place for ninety consecutive days.

Changes to Rules 26.11 (Market-Makers) and 26.13 (Floor Broker Financial

Requirements). CBOE Rules 26.11 and 26.13 relate to market basket contracts, which the Exchange does not currently list for trading. The Exchange proposes to amend those rules by deleting a provision in each rule relating to OCC approval of letters of guarantee that are amended to include market basket transactions.<sup>14</sup>

Additionally, the Exchange proposes to add an internal cross-reference, which provides that letters of guarantee or authorization issued for Market-Makers in market basket contracts, and letters of authorization issued for Floor Brokers in market basket contracts, under Rules 26.11 and 26.13, respectively, will be subject to Rule 3.28.<sup>15</sup> The effects of this addition would:

- allow CBOE to prevent access to its marketplace if a Market-Maker or Floor Broker TPH in market basket contracts does not have an effective letter of guarantee or authorization on file with the Exchange;
- allow CBOE to take action necessary to give effect to actions by the Clearing

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<sup>14</sup> The Exchange states that provision is obsolete because the OCC is no longer involved in approving CBOE letters of guarantee. See Notice, *supra* note 3, at 76323.

<sup>15</sup> Those letters of guarantee or authorization issued to Market-Makers and Floor Brokers in market basket contracts previously were governed only by Rules 26.11 and 26.13.

Corporation, such as restricting the activities of a Clearing TPH or suspending a Clearing TPH;

- allow CBOE to invalidate a market basket Market-Maker or Floor Broker TPH's letter of guarantee or authorization if it was issued by a Clearing TPH whose Clearing TPH status as a Clearing Member of the OCC is terminated or if a Clearing TPH's status as a CBOE TPH is terminated effective as soon as the Exchange is able to process the invalidation of the letter of guarantee or authorization;
- allow CBOE to invalidate a market basket Market-Maker or Floor Broker TPH's letter of guarantee or authorization, if it was issued by a Clearing TPH who has been suspended as a Clearing Member of the OCC or as a CBOE TPH, during the period of the suspension effective as soon as the Exchange is able to process the invalidation of the letter of guarantee or authorization;
- provide that the invalidation of a letter of guarantee or authorization shall in no way relieve the Clearing Trading Holder that issued the letter of guarantee or authorization of responsibility from transactions guaranteed prior to the effectiveness of the invalidation; and
- automatically terminate the trading permit(s) and TPH status of a Market-Maker or Floor Broker in market basket contracts if the Market-Maker or Floor Broker in market basket contracts does not have a required letter of guarantee or authorization in place for ninety consecutive days.

## II. Discussion and Commission's Findings

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national

securities exchange.<sup>16</sup> In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,<sup>17</sup> which requires, among other things, that the Exchange's rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. The Exchange's proposal will remove impediments to and to perfect the mechanism for a free and open market and, in general, protect investors by requiring that a TPH have an effective and unrestricted letter of guarantee, which will help prevent the execution of trades on CBOE that ultimately may not be able to be cleared and settled.

The Commission also finds that the proposed rule change is also consistent with the Section 6(b)(7) of the Act,<sup>18</sup> which requires that the rules of an exchange provide a fair procedure for the denial of membership to any person seeking membership therein and the prohibition or limitation by an exchange of any person with respect to access to services offered by the exchange. Under the proposed rule change, a TPH without an effective letter of guarantee or authorization will not be able to continue to trade on the Exchange and, if a TPH does not have a required letter of guarantee or authorization in place for ninety consecutive days, the permit of the TPH is automatically terminated. The Commission believes that it is appropriate to prohibit a TPH from trading on CBOE without a financial guarantee, and the 90-day period

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<sup>16</sup> In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition and capital formation. See 15 U.S.C. 78c(f).

<sup>17</sup> 15 U.S.C. 78f(b)(5).

<sup>18</sup> 15 U.S.C. 78f(b)(7).

provides the TPH adequate time to cure its deficiency. The Commission notes that CBOE stated that the automatic termination provision does not prohibit or limit a previously terminated TPH from applying again to become a TPH once the TPH acquires the required letter of guarantee or authorization.<sup>19</sup>

### III. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>20</sup> that the proposed rule change (SR-CBOE-2012-124) be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>21</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>19</sup> See Notice, supra note 3, at 76324.

<sup>20</sup> 15 U.S.C. 78s(b)(2).

<sup>21</sup> 17 CFR 200.30-3(a)(12).